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Chapter 10

THE FADING TRIUMPHS OFAMERICAN CAPITALISM 1945-2000

American industry entered the postwar period under highly favorable conditions, most of them direct consequences of the war. Large-scale control of the economy was broadened, wartime profits facilitated payment of corporate debt, and many new plants and machines were obtained in postwar government surplus sales. Wartime taxes were quickly repealed and numerous firms received refunds achieved by balancing wartime and postwar earnings. Federal surplus supplies of industrial materials and machinery were disposed of with careful regard for the economic interests of industry. Not least important, industry links with federal governmental bodies were not dismantled. The emergence of the Pentagon in postwar policy-making depended in part upon strengthened industrial cooperation. This extended to the realm of foreign policy as well.

The Cold War matured during five years after the end of World War II. American influence in Europe was extended by the Marshall Plan (1948-1952) which assured the U.S. access to European markets and thereby minimized the possibility of an economic slump in the U.S. economy. In addition, exclusion of communist and other left-leaning elements from European governments was exacted as part of the price for Marshall aid. At first, Marshall funds were not to be used for rearming recipient countries. By 1950, however, the U.S. had reversed itself: rearmament became the central core of its European policy.[1]

In 1950, the U.S. National Security Council delivered to President Truman a comprehensive statement on foreign policy he had requested. Titled NSC-68, it defined the outlines of American policy for years to come.[2] Fundamental conflict with the Soviet Union was regarded as ultimate reality, and rearmament of the U.S. and its allies was named as the basic means adopted to meet the threat as viewed by NSC-68. American military spending rose rapidly. As Michael Hogan writes: "During the first two decades of the Cold War the federal government invested $776 billion in national defense, an amount equal to more than 60 percent of the federal budget, and more if indirect defense and war-related expenditures are included."[3]

The scope of defense spending was enormous. As the following compilation shows, defense employment as a percentage of total durable goods employment between 1939 and 1969 expanded greatly because of the adoption of a rearmament policy in the early 1950s:[4]

Year	%	*Year*	%
1939	3	1959	17
1945	17	1960	16
1947	5	1961	16
1950	5	1962	16
1951	6	1963	16
1952	9	1964	15
1953	9	1965	15
1954	10	1966	16
1955	9	1967	17
1956	10	1968	17
1957	11	1969	16
1958	15		

During the late 1960s, U.S. defense expenditures in durable goods were at the same level as in 1945, a World War II year. The level had been at 15-17 percent between 1958 and 1969, in part the period of the Vietnam War. This followed a near-doubling during the Korean War (1950-1955). The Cold War was also a time of hot war. Rearmament proceeded in both cases.

To the writers of NSC-68, defense production promised to counteract economic slumps. During the immediate past, they cautioned:

> Industrial production declined by 10 percent between the first quarter of 1948 and the last quarter of 1949, and by approximately one-fourth between 1944 and 1949. In March 1950 there were approximately 4,750,000 unemployed, as compared to 1,070,000 in 1943 and 670,000 in 1944. The gross national product declined slowly in 1949 from the peak reached in 1949 ($262 billion in 1948 to an annual rate of $256 billion in the last six months of 1949) ...[5]

The new policy of rearmament was as much an economic, as a political and military, measure. On the eve of a recession it proved persuasive. Between 1945 and around 1986, "the United States employed military force across its borders more than 200 times."[6]

Rearmament was welcomed by many large enterprises. "Between 1947 and 1963 the top two hundred industrial corporations boosted by defense business, increased their share of total value added in the economy from 30% to 41%."[7] Many lucrative contracts were awarded without bidding. There being no civilian market for most defense goods, defense producers did not constitute competition to non-defense producers. Political connections were critical. In the absence of these, it would be difficult to discern whether a particular defense producer was a pioneer "in solid rocket work or just a firecracker factory with a long fuse into the Pentagon."[8]

Increasing federal support for research and development (R & D) contained commercial subsidies in disguise. As Mowery and Rosenberg point out:

> Most R & D expenditures are devoted to product design and testing, redesign, improvements in manufacturing processes, and so forth. Most R &D has not been science, whether basic or applied.[9]

We may add: whether financed by government or business.

In one way or another, federal patronage through research subventions or outright purchase proved decisive to the future of numerous critical products. This was especially the case in the electronic revolution after World War II. The transistor, a key innovation that emerged from the Bell Telephone Laboratories, and the integrated circuit, a product of Texas Instruments, were both non-military in origin. "Although the military market for IC's was rapidly overtaken by commercial demand, military demand spurred early industry growth and price reductions that eventually would create a large commercial market . ..."[10] Similarly, "federal spending during the late 1950s and 1960s from military and nonmilitary sources provided an important basic research and educational infrastructure for the development of this new industry."[11]

Without federal sponsorship, the nuclear power industry could not have enjoyed even its short-lived success. Federal subsidies included the following: "Subsidy of uranium exploration and nuclear fuel enrichment, partial public assumption of uranium mining and fuel reprocessing waste disposal costs, extensive Export-Import Bank nuclear subsidies, government-guaranteed markets for plutonium production and fuel processing, government assumption of liability for serious nuclear accidents (Price-Anderson Act), and deferment of nuclear waste disposal costs."[12] Between 1954 and 1979, development subsidies for nuclear power equaled $29 billion in 1987 dollars.[13] Around the mid-1950s, when U.S. military planners were advocating the adoption of programmable automation in the machine tool industry, "the government had still to expend millions of dollars and actually create and guarantee a market for numerical control before wary industrialists would take the gamble."[14]

Increasingly, as the U.S. machine tool industry became consumed with specialized military and aerospace work, foreign producers (Japanese and West German) gained a large share of the U.S. market:

> Between 1960 and 1975, U.S. imports of machine tools increased 300 percent. By 1978, the U.S. had become a net importer of machine tools.[15]

As Oskar Morgenstern explained nearly a half-century ago:

> The most interesting things in science at present are done only if they are related to war and war preparation . ... Society will not support research and enormously expensive experimentation on other grounds.[16]

The passage of time has only moderated such a perspective. This envelopment by military considerations has left some ordinary non-military industries in the United States far behind in the world market. Gregory Hooks stresses that the "threat within the defense industries is ... that the defense program will push U.S. firms into esoteric production with few civilian applications."[17] The years since the 1950s and 1960s have seen few spillovers from military to non-military commodities. (What are the peacetime uses of torpedoes or missiles? Compare these with computers and transistors.)

During the long period 1914-1975, "productivity growth was much faster than before or after."[18] After the mid 1970s, average productivity fell by half from two percent to one percent near century's end. During much of the immediate postwar years (1945-1960) "invested capital per worker increased, in constant prices, at the rate of about 3.5 percent a year . ..."[19] This robust growth provided the setting for the rise in productivity. Much of it, however, was economic shadow-boxing. As we saw above, a considerable part of the nation's production was war-spending, "the capitalization of war, death and destruction."[20] High productivity in this area did not alter its uselessness to final consumers. Nor did it diminish in the least many social problems that festered during these years. (See Chapter 11.)

Once the Korean War ended in 1955, the economy began to slump.[21] In manufacturing, writes Robert Brenner, "output grew at an average annual rate of only 1.4 percent between 1955 and 1961, compared to 5.1 percent between 1950 and 1955." Unemployment rose during 1950-1963: "During the second half of the ... [50s], the average rate of unemployment increased by more than one-third, compared to the first half (5.5 percent for 1956-61, 4.0 percent for 1950-55) and as late as 1963 remained at 5.7 percent." Between 1950 and 1958, "labor productivity in manufacturing grew at an average annual rate of 1.85 percent — compared to 5.5 percent between 1946 and 1950." During the same period of the 1950s, real wages in manufacturing rose annually by 3.6 percent. As a result, the rate of profit in manufacturing fell by 41 percent. Large U.S. manufacturing firms started investing heavily in foreign, especially European, factories in an attempt to increase profitability. At the same time, U.S. producers "unleashed a powerful across-the-board assault on [American] workers and their institutions, and achieved what turned out to be a fundamental shift of the balance of class power and in the character of management-labor relations." The anti-labor period paid off handsomely: "Between 1958 and 1965, profitability in manufacturing rose by no less than 80 percent . ..."

The 1965 peak in manufacturing profitability soon led to a decline in profitability from 1965 to 1973. During this period the rate of profit in manufacturing dropped by 40.9 percent.[22] The slump reflected growing competition in manufacturing exports from Japan and Germany. Increasingly, U.S. manufacturers were unable to match the relatively low unit labor costs in those two countries.[23] The west European economies had undergone greater development during 1950-1973 than the United States. This was true regardless of political ideology: "Authoritarian governments, both right and left wing, achieved spectacular results during 1950-73 . ..."[24] (The Marshall Plan played a very minor role in these developments.) In addition, European economic growth was accompanied by greater economic equality.[25] The opposite was the case in the United States and England.

A special factor, operative primarily in the United States, was the growing prevalence of stock options in corporate executive compensation. They began spreading during the 1950s. In one study, covering 1955-1963, stock options made up one-third of executive after-tax compensation.[26] As stock market prices rose during between 1940 and 1970, so, too, did the attractiveness of stock options. The reverse was also true: when stock prices fell, executives tended to depend for their compensation more on salary and related payments.

Lewellen studied changes in compensation of five top executives during 1950-1953 and 1960-1963. He found that stock ownership (via stock options) had risen from 76 percent of compensation income to 434 percent of compensation. In other words, they derived 20 times as much income from selling the optioned stocks (at rising prices) as they did from collecting dividends on those stocks.[27] Thus, corporate executives were becoming far more concerned with short-run strategies on the stock market than they had ever been. The larger the profit that could be shown on their company's quarterly reports, the higher the stock market valued their (optioned) stocks, and the higher the executive income from sale of their stock. Where, however, did this leave the issue of developing long-range strategies for the development of their lines of business? As options became more important, the executives' attention was more deeply concerned with improving the sales potential of their stock. In the context of the mid-1970s and after, when U.S. manufacturing underwent heightened competition, was executives' attention less fixed on high stock prices — a short-term problem — than on enduring concerns of their firms — a long-term perspective? As Lazonick points out: "There are no stock options in Japan, and even if the manager owns shares, his membership in the organization means the shares are not for sale."[28]

By 1945, American unions reached their highest level, 15 million members or 35 percent of the non-farm work force. Toward century's end membership stood at 13 million members or 10-11 percent of the non-farm work force.[29] At the peak, strikes were widespread: "The 1946 strike wave was, in terms of number of strikes (4,985), number of strikers (4,6 million), and number of days of work lost (116 million), the largest that this country has ever seen."[30] The closing years of the century, however, saw a level of union membership that was lower than before the Great Depression.[31]

The relative decline of American labor occurred in the context of unceasing attacks by industrialists whose political power did not flag: legislation, court decisions, and administrative rulings were brought to bear. American capitalists were a far more unified force at the end of the period, and they seemed not to have forgotten any trick which had been effective in the past. If employer violence receded somewhat, it was replaced by other approaches. None of these was completely new but they were more effective than earlier. Following is one example.

During times of business slumps, corporate firms increasingly demanded that unions agree to concessions or givebacks to companies. Targets of the changes were provisions in union-company collective-bargaining contracts negotiated in earlier periods. They included wage reductions, easing of work rules that would increase productivity, freezing of cost-of-living raises, early renegotiation of contracts, and other devices. Frequently, employers threatened alternatives of sweeping layoffs, plant closings, or even bankruptcies. It was under such circumstances that wages were cut in unionized garment and textile plants just after the Korean War (1950-1955). During the early 1960s, "decisions not to increase union wages were quite common."[32] In 1960, the International Longshoremen Workers Union and the Pacific Maritime Association agreed to install automation and the handling of containerized freight. "The agreement ... yielded large increases in productivity and [labor] cost savings."[33] The ILWU had earlier resisted pressures for such a turn of events but retreated under threats of widespread layoffs which would have penalized its older members. During the recession of 1979-1982, employers stepped up calls for givebacks.[34] Economists pointed to heightened competition that was leading to pressures on profits in several deregulated industries and also to increasing foreign competition. James Duesenberry referred to a sharp drop in average hourly earnings late in 1981 and early 1982.[35] The policy of givebacks was costing workers dearly.

In the steel industry, seven domestic integrated producers dominated the market. Harry and Linda DeAngelo studied how givebacks in the industry were affected by changes in managerial compensation, financial reporting, and corporate dividend policy. [36] Between 1980 and 1988, the total wage bill for all seven major producers fell to $8.6 billion from $16.1 billion. This almost 50 percent drop in wages was accompanied by a 62.9 percent cut in jobs, from 512,941 to 190,238 between 1979 and 1988. Unit labor costs, computed on those workers who remained employed, declined by some 31.9 percent.[37] "Managers," write the DeAngelos, "used the threatened and actual layoffs and plant closings to back up their claims that labor concessions were essential."[38] Meanwhile, during actual union negotiations "managers systematically depressed reported [company] earnings. ..."[39] Certain charges against profits were postponed or hastened so as to fall into periods of union negotiations, thereby accentuating the appearance of drops in profits. In addition, managers timed reductions in their own pay so that executive compensation was "significantly lower during union negotiations than for the same firms in non-negotiation years."[40] The payment of dividends to stockholders was also affected: "All seven firms reduced dividends during their financial difficulties, and ... all except U.S. Steel eventually omitted dividends altogether."[41]

Neither managerial compensation declines nor dividend reductions anywhere near matched the increase of corporate cash flow that resulted from worker wage reductions and consequent cuts in unit labor costs. By exaggerating the "material sacrifices" of executives and shareholders, it was hoped "to encourage organized labor to make (in the aggregate, much larger) concessions of their own."[42] In the main, the strategy worked. It was, however, much more a response to threats of unemployment, hunger, and family deprivation than gullibility. Similar threats had become realities since the earliest days of industrial capitalism in the United States. (See chapters 4 and 6.)

Another avenue to lower costs of production in one industry after another was expansion of capital investment and technological change. The American copper industry was a prime example of this.

During the late 1960s and early 1970s, foreign-owned copper properties in Chile, Zaire, Zambia, and Peru were nationalized; a number of these had been owned by American companies. Anaconda, one of the largest of the American firms, lost 30 percent of its net worth by the Chilean nationalization.[43] During the late 1970s and into the 1980s, profits dropped sharply. The entire U.S. industry was in a depression. Lowering of production costs was seen by the industry as the way out.

> Cost savings ... [were] obtained by closure of high-cost mines, productivity improvements through modernization of equipment and mining techniques, enhancement of ore grades by exploitation of better deposits, and lowering of labor costs . ... Computerization and a drastic thinning of management and staff ranks . ... [44]

From management's viewpoint, the program was highly successful.

Between 1986 and 1992, the cost of producing a single ton of finished copper by Phelps-Dodge fell to $1,235 from $1,874.[45] The productivity of Arizona's copper mines and plants rose by 150 percent.[46] In 1986 alone, at the Magma plants, wages were cut by 20 percent and cost-of-living adjustments in wages were eliminated. A bitter strike in 1983 against Phelps-Dodge was lost by workers; the next year members voted to decertify the union. During the years 1988-1994, Phelps-Dodge earned an average annual profit of $311 million. Employment in Arizona's copper production fell by half between 1981 and 1992. The burden of these 13,000 lost jobs fell heavily on Mexican American and American Indian workers. A standard economic work on the copper industry hailed the seven biggest firms for their "marked industrial courage" for having "been … relentless in actions necessary to cut labor costs."[47]

The 1980s witnessed a sharp decrease in strikes over the entire country, falling by more than half since the preceding decade.[48] Many union contracts were simply extended without a strike and, presumably, lacked any union-requested changes.[49] A study of the years 1984-1988 found that permanent strikebreakers were employed in nearly one-sixth of all strikes analyzed; in New York, the sample rose to nearly one-quarter.[50] Temporary strikebreakers were employed less often, six and ten percent respectively. Cynthia Gramm observed that "the willingness of employers to hire permanent replacements … increased during the 1980s."[51] This shift in employer policy documented a sharp decline in worker rights. Workers' readiness to strike ebbed further. "On March 8, 1995, President Clinton signed an executive order banning the federal government from doing business with firms that use permanent replacements."[52] The next year, a panel of the District of Columbia Court of Appeals struck down the presidential order. In 1999, the International Confederation of Free Trade Unions cited U.S. employers' use of permanent replacement workers during strikes as a denial of the right to bargain collectively.[53]

Job stability in the private economy was severely weakened during much of the last third of the 20th century. Layoffs were higher for blacks, workers recently hired, and workers in operative and construction jobs.[54] During 1984-1992, Fairlie and Kletzer found, "black men experienced rates of job displacement that were 30 percent higher and reemployment rates that were 30 percent lower than the corresponding rates for white men."[55] Samuel Farber found that upon reemployment, workers received wages about 13 percent lower than in their former jobs.[56] Not only did such workers suffer wage losses, but also many also lost accumulated seniority and thus certain employee benefits such as pensions, vacations, health insurance, and others.[57]

Jacobson and others studied long-term losses of high tenure manufacturing workers in Pennsylvania over a period of thirteen years (52 quarters). Even five or six years after the initial job loss, these workers were earning only three-quarters of their predisplacement pay.[58] The researchers observe that "there is little evidence that displaced workers' earnings will ever return to their expected levels."[59]

Daniel Polsky, studying two periods (1976-81 and 1986-91), found a new factor at work:

> In the 1986-91 period it became much more difficult for workers who lost a professional or managerial job to become reemployed relative to those in service occupations: their mean probability of reemployment dropped from .78 to .65 between the two periods.[60]

Polsky also reported that workers who lost jobs experienced less real-wage growth in the second than in the first period. All in all, Swinnerton and Wial conclude that increasing job instability had become the rule by the mid-1990s.[61] Robert Valletta, in a separate study, "identified a long-run trend toward declining job security that probably continued through 1996."[62] In a second study, Valletta, writing in 1998, declares that despite low unemployment:

> The duration of unemployment spells has remained long compared to typical durations during previous expansions . … Moreover, the structure of unemployment by season during the 1990s expansion has remained heavily weighted towards permanent job loss rather than voluntary job search and labor force entry decisions.[63]

Between 1976 and 1998, Valletta continues, "the expected duration of unemployment was 17 weeks for permanent job losers and 12 weeks for all unemployed."[64] In Puerto Rico, joblessness during 1990 for men aged 20-29 rose to 24% from 7% in 1970; for women similarly aged the respective percentages were 29% and 8%.[65]

Real family income boomed during the earlier postwar years. Between 1949 and 1973, for example, it rose at an annual average rate of 3.2 percent. During the next period, 1973 to 1996, however, it slumped to 0.3 percent per year — a drop of more than 90 percent.[66] Productivity in the nonfarm business sector also slumped from 2.2 percent annually in 1948-1973 to 1.0 percent in 1973-1996.[67] This lag between real income and productivity grew larger during the second period. Perhaps nowhere in the economy did this gap widen as in mining. As Madeline Zavdny notes: During the years 1977-1996, "productivity in the mining sector increased 65 percent while compensation rose about 8 percent in real terms, resulting in productivity increases that far outpaced real compensation gains."[68] As we saw above, these were the years that copper mining underwent enormous growth in profitivity. The gap was smaller in unionized industries.

Only in 1996 did wages begin to outstrip the rate of inflation— a trend that had last occurred in the early 1970s.[69] In that same year—1996—Congress raised the minimum wage which by 1999 stood at $5.15 an hour—far lower in purchasing power than in 1968 when it was worth $7.49 per hour in 1999 dollars.[70] Low-skilled workers' earnings dropped by 13 percent per year during 1979-1989.[71] Low-skilled immigrant workers fared worst: "The proportion of [such] ... workers living in poverty grew from 21 percent in 1980 to 36 percent in 1990.[72] A study by the U.S. Department of Labor found that "a growing number of workers at the bottom of the pay scale have lost access to key employer-provided benefits."[73] A former Secretary of Labor wrote that "most workers — knowing how easily they can be replaced by technology or global 'outsourcing' were their wages to rise — dare not demand raises."[74]

Since the 1960s, two world-wide economic developments have impacted American wages: foreign trade and international investment.

Taking the electronics industry as an example, in 1972 there were 46,000 workers in 350 plants on the Mexican border; two years later, the figures were 83,000 and 527. All but a few of the plants were American-owned. In Taiwan, plants producing for U.S. electronics manufacturers began with single components but in time put out complete units. Between 1969 and 1973, electrical apparatus imports from developing countries rose from $339 million to $1.7 billion. Partial relief was afforded by passage of the Trade Expansion Act of 1962 which offered workers adjustment assistance as well as relocation allowances if increased imports were the cause of the unemployment.

Awards of aid to affected workers were administered by the U.S. Tariff Commission as Trade Adjustment Assistance (TAA). In fact, however, "the ... Commission rejected all worker petitions through fiscal year 1969, and less than 50,000 workers won benefits between then and 1974."[75] The Carter administration increased TAA funds eight-fold, from $200 million to $1.6 billion in fiscal 1980. The program was cut sharply by the Reagan administration. A new chapter in this old story was written in 1992 with the signing of the North American Foreign Trade Agreement (NAFTA). The result was a further departure of relatively high-wage jobs to Mexico where they were transformed into comparatively low-wage jobs and high rates of profitivity for American and Mexican employers.

An entirely different outcome was experienced by aluminum workers who were members of a steelworkers' union in Ravenswood, West Virginia.[76] In November 1990, when a union contract with the Ravenswood Aluminum Corporation expired, the company proclaimed a lockout which lasted until June 1992. In 1989, when new owners bought the plant:

> Almost immediately, RAC management instigated new work rules and a speedup of production, dissolved joint management-union safety programs, and combined several employment categories to eliminate nearly a hundred jobs. During the following 18 months five workers were killed and several others injured in accidents at the plant.[77]

Workers deeply resented this turn of events. During the 1980s, they had rejected tentative contracts negotiated by union leaders that contained givebacks they had earlier won. Solidarity was the keynote of their local organization. Of 1700 members, only one percent failed to respect picket lines during the 1990-1992 lockout.[78]

Instead, however, of simply picketing and intermittently bargaining with RAC, the union undertook a novel strategy: RAC was owned by Marc Rich, an American whose world-wide plants controlled about a third of the world aluminum market and who was a fugitive from U.S. law-enforcement authorities on various charges. The heart of Rich's empire was located in Switzerland where the RAC local union and its parent United Steelworkers Union sent representatives to pressure the Swiss legislature and Swiss unions into supporting their cause. The campaign extended into Czechoslovakia, Romania, Bulgaria, Russia, Jamaica, and Venezuela. Altogether Rich's properties in 28 countries felt the impact of the campaign. By April 1992, RAC had lost so much business that it was compelled to end the lockout. In addition, the local union filed a formal complaint with OSHA, a federal health agency, against RAC. Near the end of 1991, OSHA found RAC guilty of 231 safety and health violations and required the company to pay a fine of $604,500. A new contract was negotiated with the union, which embodied a number of workers' demands.

The years 1979-1994 have been called "undoubtedly the most turbulent period in U.S. banking history since the Great Depression."[79] Industry assets experienced a fundamental redistribution between banks of under and over $100 billion in assets; the former called "small", the latter "megabanks". At the beginning of the period, the former represented 13.9% of industry assets, and only 7.0 percent at the end; the figures for the former were 9.4% and 18.8%. Berger and his colleagues note that "at the beginning ... there were typically fewer than ten [bank] failures per year, but ... by the end of the 1980s, more than two hundred banks were failing annually—a twentyfold increase. ..."[80] Economic slumps and regional difficulties explained part of these failures. Another part, little discussed, was due to fraud and related events.

With respect to national banks, the Office of the Comptroller of the Currency (OCC) found:

> Insider abuse and fraud were significant factors in the decline of more than a third of the failed and problem banks the OCC evaluated. Much of that insider abuse or fraud involved directors, senior management, or principal shareholders or was related to their failure to provide adequate oversight and controls.[81]

The OCC also observed that "about a quarter of the banks with significant insider abuse also had significant problems involving material fraud."[82] Of 3,596 defendants indicted or charged by U.S. attorneys, 2,243 pled guilty.[83] The Department of Justice "convicted 2,603 defendants in major bank and thrift fraud cases."[84] The Federal Deposit Insurance Corporation (FDIC) reported that charges of alleged criminal fraud by "former directors, officers, or principal shareholders were made involving nearly half of banks that failed in 1990 and 1991."[85] The Federal Bureau of Investigation (FBI) investigated possible fraud or insider abuse into the early 1990s. In 1987, there were 11,555 investigations and 21,607 four years later, an increase of 87 percent.[86]

Staffing levels of the federal banking regulatory agencies were inadequate to examine the financial soundness of banks under their supervision. Between 1980 and 1985, there was a five-fold increase in the numbers of problem banks in FDIC's jurisdiction. But by 1985, 25 percent of FDIC vacancies were unfilled. Fewer banks could be examined: "Between 1979 and 1986, the mean examination interval in days for all commercial and savings banks increased dramatically from 379 to 609."[87] Bank examiners unable to maintain current schedules of examinations were forced to depend on outdated information. As FDIC discovered later, "overall, 565 banks, or approximately 36 percent of those banks that eventually failed, held a satisfactory 1 or 2 rating [out of 5] two years before failure."[88]

In retrospect, it was learned that many failed banks, eager to earn profits, lent money all too readily to finance unnecessary or questionable projects. This was especially the case in commercial and industrial building. By 1990, "Manhattan ... [had] 25 million square feet of vacant office space . ..."[89] In 1985, "Dallas had 34 million square feet of unleased office space — more than the total office space in Miami."[90] In Harris County (Houston): "In some communities, foreclosure rates were in excess of 60 percent."[91] In many cases, the overbuilding of commercial and industrial properties was caused by defective appraisal policies: "Flawed and fraudulent appraisals were often used by federally insured financial institutions, both banks and savings and loan associations."[92] A Congressional committee "found widespread evidence of incompetence and fraud with appraisal practices, primarily at thrift institutions but to some extent at commercial banks."[93]

During the 1960s through the 1980s a movement gained strength to compel banks to make mortgage money available in communities in which banks were located. Not until the 1990s, however, did "community reinvestment" become a significant movement. Thus, "more than 350 agreements totaling over $397 billion had been signed by banks and community organizations by the end of the first quarter of 1998, ninety-five percent of the total since 1992."[94] Between 1991 and 1995, "conventional home-purchase loans to whites increased by two-thirds, loans to blacks tripled and those to Hispanics more than doubled."[95]

A large-scale wave of bank mergers and acquisitions occurred during the last five years of the century. Megabanks were the dominant movers in this wave. During the 1980s, the average number of such mergers per year was 385; during 1990-1998, the figure rose to about 510.[96] Behind this movement lay not only an attempt to increase market control but also to obtain the blessings of deposit insurance without bearing the full cost. In order to avoid the failure of larger megabanks, authorities decided that such banks were "too big to fail". Therefore, deposit insurance was extended to depositors even though deposits exceeded the upper limit of $100,000 per account. Such banks did not have to pay insurance premiums to the FDIC.[97]

During the years 1980-1994, there were 1,617 bank failures. In the quarter preceding failure total assets of these banks were over $316 billion.[98] In 1999, the *New York Times* estimated editorially that "the bill for cleaning up the savings and loan mess ... [was] already at $480 billion."[99] This sum far exceeded the total of deposit insurance paid by covered banks. The remainder was provided from federal revenues paid by the general public. In 1999, the nation's eighth largest bank, Bankers Trust Corporation of New York "pleaded guilty ... to criminal charges of illegally diverting $19.1 million in cash and other assets that the law requires to be turned over to states."[100] This may be compared to the previous year's case of the Bank of America Corporation agreeing to pay $187.5 million "to settle California charges that it had mishandled hundreds of millions of dollars over more than 15 years."[101] Bankers Trust was ultimately acquired by a German bank, while Bank of America—one of the nation's largest—tripped merrily on.

Between 1927 and 1956, according to Victor Perlo, the percentage of the U.S. population that were stockholders ranged from 3.4 to 8.9.[102] He found further that "stock ownership is still occasional, rather than typical, for workers, and rare for industrial workers."[103] Concentration of shareholding was extreme at the other end in 1952: "Less than one percent of all American families owned over four-fifths of all publicly held stocks owned by individuals."[104] Perlo estimated that about 10 percent of Americans owned stock. By 1998, nearly a half-century later, 85 percent of all stock was owned by the top 10 percent of the population[105] and forty-three percent of the people owned some stock.

A survey in 1999 found that the typical owner of stock and other equity instruments

> has household income of $60,000 and household financial assets of $85,000. Most ... are college graduates.[106]

Stockholdings were highly concentrated.

> A large number of equity owners hold small-to-moderate amounts while a small number hold exceptionally high levels of equity assets ... 7 percent of household owners have equity assets of $500,000 or more. In contrast, 30 percent have less than $25,000 invested in equities.[107]

Except for a small number of stockholders who owned large amounts of stock, very few could support their customary level of living with dividend income alone from stockholdings. During the late 1950s, for example, a person who owned about $1,000 worth of stocks might expect dividend income of about $40 per year, or the equal of wages for two days' work.[108] For most small stockholders, owning stock constituted a marginal recreational enterprise. In 1952, individuals and families owned 92 percent of corporate equity but by 1994 only 48 percent; pension funds and mutual funds had increased their shares of corporate equity to make up the difference.[109]

An expanding stock market meant little to the corporations whose stock was traded on the market, especially in relation to their funds for capital investment. These funds were obtained from the corporations' accumulated profits, depreciation reserves, and long-term bonds issued by the corporations. (Together, profits and depreciation were known as "retained earnings". In other words, they were derived from internal sources of the corporation.) Unlike a half-century or so ago, individual corporations were not dependent on banks and other financial institutions for their capital funds. During 1921-1929, internal funds of 84 large manufacturing corporations were just enough to cover all their fixed capital expenditures. During the years 1970-1985, retained earnings provided 86 percent of net capital funds for non-financial corporations.[110] U.S. corporations endured and succeeded handsomely in a financial sense. At the same time, many neglected the task of innovation, and as a consequence by the 1980s a number failed to compete effectively in world markets:

> During the three-year period beginning in 1980, Ford Motor Company lost $3.3 billion, an amount equal to 43 percent of its total net worth. These were the largest losses ever by a U.S. corporation . ... In 1991 ... [the Big Three] lost a total of $10 billion in their North American businesses.[111]

Volume of trading on the New York Stock Exchange in 1950 was puny by later standards: "Trading volume for all of 1950 totaled 525 billion shares, equal to about two average days' trading in 1993, and a vigorous day in 1996."[112] By century's end, *daily* volume was double that of the *annual* 1950 total.

In 1992, as the stock market registered enormous gains, Louis Lowenstein, a professor of both law and finance at Columbia University, wrote in the *Columbia Law Review*: "The stock market ... is now, and, has always been a hotbed of manic-depressive pricing, manipulation, and outright fraud."[113] To what degree did the rising market of the 1990s resemble Lowenstein's "hotbed"?

An axiom of financial reporting is that "stocks soar on good news, no matter how expensive they already are."[114] No news is almost as good, but bad news must be avoided altogether. When Procter & Gamble's profit dropped only moderately, the stock lost $40 billion in market value.[115] To managers of stock funds of various sorts, profit drops and consequent stock price drops are simply unacceptable. In the 1990s, this pressure on corporations, stock brokers, and others led some to claim success even when this was contrary to the facts. There was outright falsification or various invented versions of reality.

The chief accountant of the Securities and Exchange Commission warned against "trying to put a better spin on "numbers that may be in fact misleading."[116] She noted that "more than half of the cases of financial reporting fraud involved an overstatement of revenue."[117] S.E.C. chairman Arthur Levitt declared that "too many corporate managers, auditors and analysts are participants in a game of nods and winks."[118] He labeled some corporate revenues as "fictional". Baruch Lev, professor of accounting at New York University, stated that "there is no doubt that, on average, reported profits are overstated."[119] The editor of *The Technology Review* comments on "the remarkable degeneration in the quality of earnings reporting that we have seen in the last two or three years."[120] Warren Buffett, a large-scale finance capitalist, attacked CEO's for having "worked purposefully at manipulating numbers and deceiving investors."[121]

Financial writer Gretchen Morgenson reports that "there is growing concern among some accounting professionals that many companies are relying on financial alchemy to burnish their results."[122] A veteran bank stock analyst comments: "There have always been companies willing to do this, but the practice is now more widespread and is being seen at even the most respected of firms. The actions are getting more desperate."[123] The *New York Times* declared editorially: "Investors lost a lot of money, in part because they relied on fraudulent or misleading financial reports issued by companies and certified by their auditors."[124]

Two extremely large cases of stock fraud were concluded in the year 2000.

One concerned CUC International which had been purchased earlier by Cendant Corporation. Cendant soon discovered that CUC's earlier financial reports had been falsified for a number of years. Over a period of three years, "more than $640 million in profits ... had been fictional."[125] In the words of a report by the S.E.C.:

> For more than 12 years … certain members of CUC's senior and middle management devised and operated a systematic scheme to inflate operating income at CUC. The scheme was driven by senior management's determination that CUC would always meet earnings expectations of Wall Street analysts and fueled by a disregard for any obligation that the earnings reported needed to be "real".[126]

Three top managers pleaded guilty to criminal fraud. Investors had lost $19 billion in the form of stock prices that fell after discovery of the falsification. Cendant agreed to pay a $2.85 billion settlement of a lawsuit by stockholders against the company.

Ernst & Young, one of the world's largest accounting firms, which had served as Cendant's auditor, was the object of another lawsuit. It was settled as follows: "Ernst & Young agreed … to pay $335 million to settle accusations that it failed in its responsibilities when it certified financial statements that fraudulently inflated the earnings of the Cendant Corporation. …"[127]

Another case of stock fraud concerned Centennial Technologies. Its C.E.O., Emanuel Pinez, was sentenced to five years in federal prison and directed to make restitution of nearly $150 million. In 1996, Centennial had been the leading stock on the New York Stock Exchange. Pinez and two other officials of the firm "had 'cooked the books', creating a phony list of receivables."[128]

The country's leading drug wholesaler, McKesson HBOC, announced that it had unknowingly recorded higher earnings than were warranted over the past three years via the former HBO firm which it had acquired. McKesson stated it would reduce its operating income for the past three years by $191.5 million. Upon this announcement, McKesson's stock fell by 48%. Apparently, the earnings problem emerged during a regular audit by Deloitte & Touche.[129]

Following are several more examples of problematic corporate treatments of profits:

> Rite Aid disclosed that its profits for 1998 and 1999 had been overstated by more than $1 billion . … Rite Aid acknowledged that it had overstated profits in numerous ways. … [Rite Aid's new C.E.O. as of December 1999] declined to say whether he thought fraud was involved, saying he would leave that to the government investigation underway.[130]

> [Micro Strategy Inc.] said its auditors had forced it to defer a quarter

> of the $205.4 million in revenue it had reported for 1999. ... [Its stock fell by] 62 percent in NASDAQ trading. The plunge wiped out nearly $12 billion in market value for the company.[131]

> American Online agreed to pay a fine of $3.5 million and to restate its books from 1995 and 1996 ... after the Securities and Exchange Commission charged that the company had improperly inflated profits by hundreds of millions of dollars.[132]

> Four executives, including the chief executive and chief financial officer, at Aurora [Foods] resigned as the company said it would start an investigation into its internal accounting practices . ... The company said ... that it had reduced its earnings for the first three quarters of 1999 by $43.3 million and reduced its 1998 third—and fourth—quarter earnings by $38.3 million.[133]

Organized crime in New York was found to be behind a $50 million stock fraud "led by the Bonanno and Colombo families with cooperation from the Genovese, Gambino and Luchese families."[134] Personnel of the scheme included "57 licensed and unlicensed stockbrokers, 12 stock promoters, 30 officers or other executives of firms issuing stocks involved in the frauds, three recruiters of corrupt brokers, two accountants, an attorney, an investment adviser, and a hedge fund manager."

As Louis Lowenstein warned in 1992, manipulation and fraud were rife in the contemporary stock market. So, too, were they in banks and savings and loan associations during the 1980s and into the 1990s. Where were the thousands of governmental regulators while these conditions were maturing? The rate of fraud and other crime in the banking field during the 1980s possibly matched robbery and burglary in other more conventional places and times.

Recessions of varying severity made up one-fifth of the post-World War II years. Writing in 1992, Vatter and Walker state that "there have been no extended periods of rapid economic growth in this century without rapid growth in government purchases."[135] In the 1980s, when the U.S. machine tool industry experienced a 60 percent drop in sales,"U.S. military orders [for machine tools] rose 65 percent, thus taking up a large part of the slack owing to collapse of civilian markets."[136]

During the Carter-Reagan era (1977-1987), defense purchases in constant dollars rose from $180 to $292 billion or from 5.3 to 6.5

percent of gross domestic production (GDP).[137] Such defense spending created 2.1 million private jobs.[138] Peak defense funding under Reagan was reached in 1987, the approximate "end" of the Cold War. During the next seven years, defense spending dropped 36 percent.[139] By 1998, the military procurement budget was "effectively 69 percent lower ... than in 1985."[140] As Leslie Wayne indicated, however, "the 1998 military budget of $255 billion — with around $100 billion a year for procurement and research — makes the Pentagon one of the biggest customers around."[141]

With falling military budgets, jobs related to defense production also declined:

> In 1996, defense-related employment was responsible for 255,000 fewer jobs than the previous post-Vietnam War low in 1977. Of the decline in employment, 42 percent, or 1 million jobs, was in Government — including the Armed Forces, and civilians in the Department of Defense and nondefense agencies. The remainder of the decline in employment (1.5 million jobs) occurred in the private sector.[142]

Compared with defense spending in Russia, American reductions were comparatively shallow:"The annual rates of defense expenditure cuts in Russia have been 6.5 to 9 times greater than in the United States."[143] By 1999, however, the Clinton administration and its Congressional allies were projecting "the first major increase in military spending since the mid-1980s."[144] Weapons procurement was to rise from $53 billion in fiscal 2000 to $75.1 billion in fiscal 2005.[145]

Over one-third of California's unemployment during 1990-1993 was attributable to cuts in defense procurement and research and development contracts.[146] Between 1987 and 1991, employment in the aerospace industry of metropolitan Los Angeles fell by one-seventh. ("Los Angeles, not Detroit ... is the biggest manufacturing center in the United States.")[147]

When the modern federal income tax was initiated in 1916, it was intended to apply primarily to the country's rich. It was thus a largely progressive tax. As late as 1940, barely one-quarter of the country's workers filed income tax returns.[148] When, however, in 1943, during World War II, the income tax was extended to the population at large, "political elites [were] enabled ... to reduce tax rates on high income groups."[149] Income tax rates on corporations were eased, especially after the Korean War (1950-1955).[150] By 1956, the corporate income tax constituted 28 percent of all federal tax revenues, but 30 years later the figure had declined to only eight percent.[151] Even when corporate rates were raised—which happened from time to time—the companies increased prices to protect their profits.[152] Stockholders, who were primarily upper middle-class, were taxed heavily in theory but only moderately in practice. In 1963, for example: "The nominal tax rate for families with incomes of $280,000 ... was 72.76 percent, but the effective rate for families with incomes of $280,000 or more was only 42.53 percent.".[153]

Taxing by ability to pay changed over the years:

> Progressivity rose dramatically during World War I, dropped in the years following that war, rose sharply during the Great Depression and early years of World War II, and then declined gradually, with only relatively minor fluctuations in recent decades. By 1982, the difference between the effective income tax rates paid by moderate income families and very high income families had fallen to 25.10 percent, its lowest point in five decades.[154]

Allen and Campbell, in their review of tax policy in the years 1916-1986, observe:"The ideological differences between Republicans and Democrats regarding tax policy are more a matter of partisan rhetoric than substantive policy preferences."[155] At the same time, "political elites [of both parties] try to satisfy the demands of special interest groups while providing symbolic assurances that placate the general public."[156] After their detailed examination of the 70-year period Allen and Campbell concluded that "it is not clear that the Democratic Party is any more inclined than the Republican Party to tax capital."[157]

According to an Internal Revenue Service (IRS) audit in 1988, "about 40 percent of U.S. households underpaid their taxes for that year."[158] IRS audits are the primary avenue to recapture omitted tax payments and overall they are highly successful in attaining their goal. Among farmers and sole proprietors of businesses, understatements of taxes are "substantially more than other taxpayers."[159] In 1965, the rate at which individual returns were audited was 4.75 percent.[160] Starting in 1968, the rate of audits for corporate returns started to diminish; by 1990, it had plummeted to 0.8 percent.[161] Similarly, in 1986, the IRS audited 21 percent of all estate tax returns, paid mostly by the very rich. By 1995, the figure was only 14 percent.[162]

As the stock market sped upwards in the second half of the 1990s, the tax position of the very rich eased greatly. "Since 1998," reported the *New York Times* in 2000, "audit rates for the poor have increased by a third, from 1.03 percent, while falling 90 percent for the wealthiest Americans, from 11.4 percent."[163] The newspaper also reported that "among the largest corporations, those with more than $250 million of assets, the audit rate was 34.5 percent . . . [in 1999], down from 54.6 percent in 1992."[164]

Meanwhile, the poor were being squeezed by the tax burden. Between 1975 and 1985, poverty expanded to 16.7 percent from 11.4 percent. In the earlier year personal taxes made up 1.3 percent of poor persons' income. A decade later, the figure had risen to 10.5 percent.[165] Danziger and Gottschalk note that the increase "offset the value of any food stamps the family might have received."[166] Another study, embracing local and state taxes, found that in 1988, "the average burden of taxation on poor families and individuals was 15.3 percent in Massachusetts and 18 percent in New York."[167] When, in 1986, Congress actually reduced the federal tax burden of the poor, state and local governments did not follow suit.

Political mobilization of corporate business paid high dividends. As Cathie Jo Martin put it:

> Political leadership has become excessively dependent on corporate allies. Private sector/groups have assumed many state functions such as drafting legislation, acting as legislative liaisons, and generating legitimation . ... Business coalitions have become almost a part of the state apparatus . ... Business mobilization strategies have accelerated the appropriation of state power for private ambitions and aggravated the lopsided balance of class power.[168]

This trend, which had reached previously unattained heights at the end of World War II, now, a half-century later, swept to new, higher altitudes.

SUMMARY

Foreign economic policy became a major safeguard against a repetition of the Great Depression. By 1950, a new policy of rearmament led to extraordinary levels of defense spending which were viewed as an anti-depression factor. Federal sponsorship of nuclear power and other expensive technical innovations were disguised subsidies. Military applications became crucial in a number of industries with the result that the U.S. was overtaken by Germany and Japan in peacetime products such as machine tools. Productivity was at high levels. The growth of stock options in American industry led to less interest among executives in meeting foreign competition. Unionization reached new heights by 1945 and strikes were widespread. Within a few years, however, the labor movement started to ebb. During the early 1980s, industry was increasingly able to enforce a policy of union givebacks or concessions. Particularly in the steel industry givebacks bulged large. In the same period, some industries – copper, especially – initiated programs of automation and other new technology that undermined wage standards. Unionization stalled.

Job stability was severely weakened during much of the last third of the 20th Century. Between 1973 and 1996, real family income rose by only 0.3 percent per year – a drop of over 90 percent from the average of 1949-1973. Wages lagged behind inflation between the mid-1970s and the mid-1990s. Trends in foreign trade and investment affected U.S. wages negatively. The years 1979-1994 were "the most turbulent period in U.S. banking history since the Great Depression." Insider abuse and outright fraud produced many bank failures, numbering 1,617 in the years 1980-1994. The cost of savings and loan failures neared half a trillion dollars. The expansion of the stock market since the early 1980s also stimulated manipulation and fraud. This included large-scale misrepresentations of the level of profits reported by large corporations. Defense expenditures slumped from the 1980s onward but remained quite massive.

Federal income taxes were eased especially for the very rich with both major parties waging rhetorical rather than substantive attacks on the wealthiest. The frequency of I.R.S. audits was reduced for the richest and for the largest corporations.

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